Discussion of "The High-Frequency Impact of News on Long-Term Yields and Forward Rates: Is it Real?" by Meredith J. Beechey and Jonathan H. Wright

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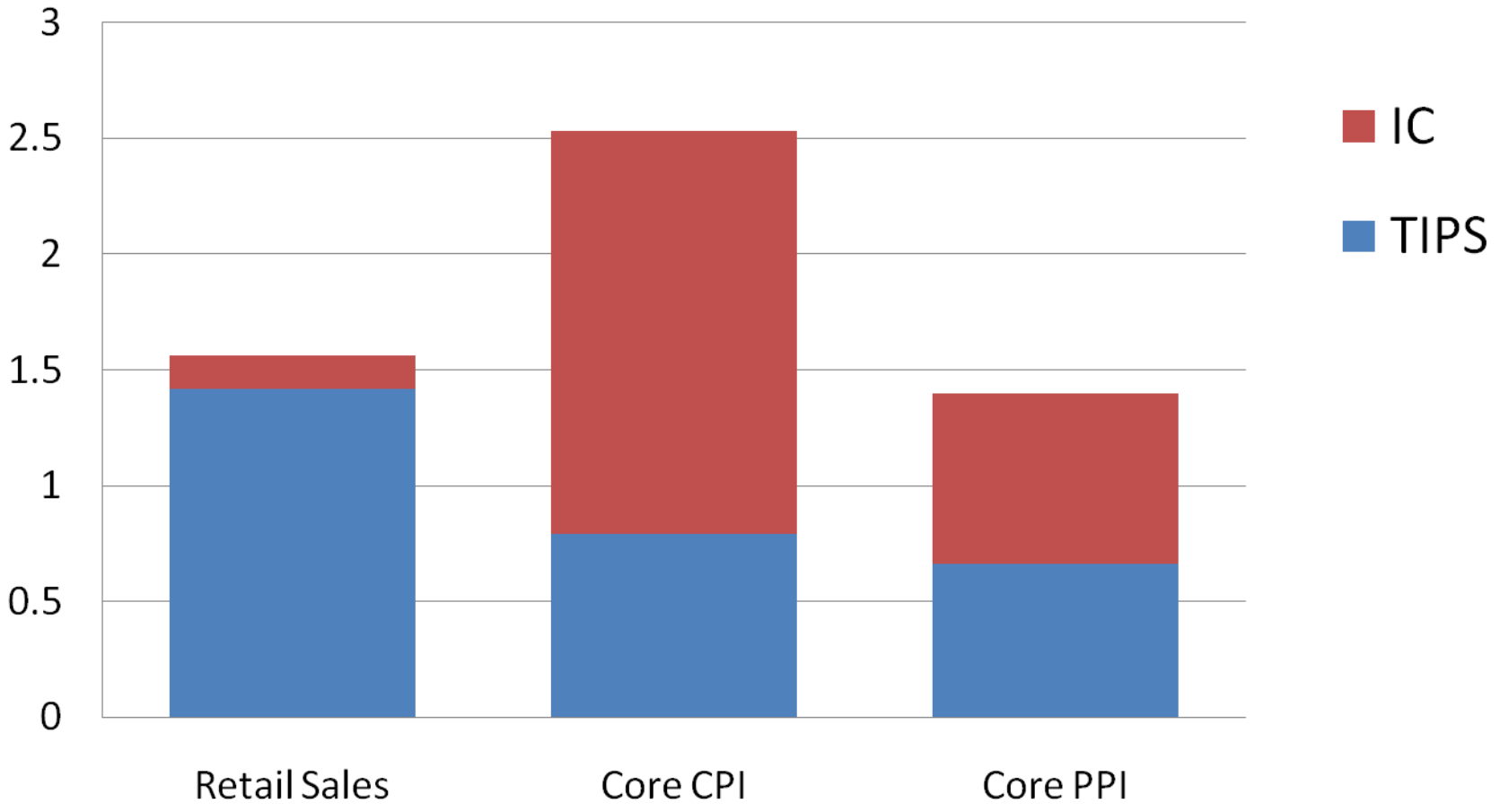
Setup

- Surprise $$s_{jt} = \frac{A_{jt} - E_{jt}}{\sigma(A_{jt} - E_{jt})}$$
- TIPS react as fast as nominal yields
- Decomposition $$\Delta y = \Delta r + \Delta IC$$

5-year Rate



Findings

- Prices affect IC more than TIPS
- Real activity affects TIPS more than IC
- Forward IC
  - Forward IC does not react to real activity news
  - Forward IC reacts only to CPI, PPI and FOMC

FOMC shocks

- No impact on y
- Positive impact on r
- Negative impact on IC

What we learn

- Long real rates are far from constant and react to real news
  - Macro models need to be updated
- Inflation compensation increases with unexpected inflation and decreases with monetary tightening

What we do not learn: Expectations or risk premia?

- Response to inflation shocks:
  - Expectations or risk premia?
- Response to real activity:
  - Expectations or risk premia?
- Does it matter?
  - Yes!

Recent literature

- Risk premia are large and move a lot
  - Forward are not expected future rates
  - Expected future rates are more closely related to current rates than to current forward rates
  - So long forward rates do not tell us much about future short rates

Monetary policy

- The view that "*the central bank sets the short rate, long rates are expected short rates, and that is how money influences the economy*" runs counter to the evidence

What are these risk premia?

- An important point (from Vayanos-Villa preferred habitat model)
  - One factor model with arbitrageurs
  - All yields move together in response to relative supply changes!
  - The idea that long and short rates contain different types of information is not obvious

What are these risk premia?

- Think about current crisis
  - Large uncertainty: No idea which model is correct
  - Financial sector in trouble
- Exploit these ideas

Suggestion 1: Uncertainty

- Consistent versus inconsistent data
- Distinguish response to news that confirms or contradicts past news

Suggestion 2: Wall-Street state variable

- Condition on macro state
  - risk premia from corp bonds and CDS
  - VIX
  - Wall St balance sheets
- Are responses larger then?

Why this might help

- Sometimes large coefficients with large errors
- Why?
- At high frequency shocks are well identified?

  → conditioning is needed
- Should also improve explanatory power

One last suggestion

- The elephant in the room:

Fiscal policy news!!!